



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

THE TEXAS STOCK AND BOND LAW AND ITS ADMINISTRATION

SUMMARY.

The law limits the amount of stocks and bonds to the reasonable value of the property, 109-111.—A fixed scale of construction prices used toward ascertaining such value, 111, 112.—Different position of old roads and of new; problems as to the old roads, 112-116.—Floating debt not affected; income bonds a means of evasion, 116, 117.—Effect on new construction difficult to state, 117-120.

A RAILROAD commission of the mandatory type was established by an act of the legislature of Texas, April 3, 1891. In the course of the litigation which arose early under this act it was stated by the representatives of the railroads, and repeated by a judge of the Circuit Court of the United States, that rates should be such as would pay operating expenses and capital charges, including a dividend on stock. In view of this assertion, in the beginning of the life of the Commission, of a relation between capitalization and rates, and of the certainty that it would reappear when rates fixed and to be fixed by the Commission were under consideration, it was made evident to Texas law-makers that without some authority over capitalization the power of the Commission to fix rates would be seriously handicapped. The law regulating the issue of stock, bonds, and other indebtedness secured by lien or mortgage of railroad companies within the State of Texas, enacted April 8, 1893, may be regarded, therefore, as legislation designed primarily to make more effective the rate-making power conferred upon the Commission by the original act.

Regulation of issue as a protection to holders and purchasers of securities was one of the considerations in the passage of the act; but it was not the main one. The percentage of resident holders was, and still is, negligibly small, and there was no demand for legislation in the interest of possible future holders of securities.

The act regulatory of issue is popularly known as the Texas Stock and Bond Law. It declares that regulation of this character is vested in the State government. It provides that hereafter railroad indebtedness secured by lien or mortgage, together with the capital stock, shall not exceed the reasonable value of the property, and provision is made for the valuation by the Railroad Commission of each railroad,—such valuation to be of the “franchises, appurtenances, and property.” In the event of the sale of a road under foreclosure it is provided that the old stock shall be annulled, and that the debt, to satisfy which the sale is made, shall not be a claim or lien on the property. Bonds may be issued in advance of the completion of a road if the Commission is satisfied with the exhibit of the data showing the value of the property proposed as security. The life of a bond shall not be more than thirty years, and the rate of interest shall not exceed 6 per cent. There are three stages defined in the procedure of issuing bonds. First, the issue is authorized by the Commission, after an exhibit by the company of the security proposed. Second, the issue is approved, if the Commission is satisfied that the security is as represented. Third, the bonds are registered in the offices of the Secretary of State and of the Commission. The law provides that there shall be no increase of stock unless all existing shares shall have been paid in full or all unpaid shares sold out as forfeited under the law. The unlawful issue of any stock or bonds works a forfeiture of the charter of the company and a nullification of the securities so issued. Any officer who shall knowingly make a false statement to secure registration of any bond or other evidence of debt, or who shall negotiate or cause to be negotiated any such security, shall upon conviction be punished by confinement in the penitentiary at hard labor.

According to section two of the act the limit of the issue of securities is the reasonable value of the property. It is provided, however, that in cases of emergency—and this is construed to refer to great damage from fire or flood—

an issue of not more than 50 per cent. over the value of the property may be authorized by the Commission.

There is no definition in the act of what is "reasonable value." Wide discretionary power is thus left to the Commission. From the beginning, however, the policy of the body has been to interpret the law as pointing to cost of construction as the measure of reasonable value in the case of new roads, and to cost of reproduction in the case of roads built before the law was passed. But there has been no rigid confinement of value to cost.

All donations in the form of right of way, depot ground, terminal facilities, land grants, and such, are allowed to be entered as bases of securities, and they are valued for that purpose at what it would cost to reproduce them. Further, the Commission has a scale of construction and equipment prices which is based on an average cost of labor and materials, and the prices of this scale are the limit which the Commission will accept as a basis for the valuation of property that is purchased. For example, fifteen cents per cubic yard is allowed in the scale for excavation work. If the railroad can get its excavation work done for twelve cents per cubic yard, the valuation of such work accepted by the Commission for the issue of securities is, nevertheless, fifteen cents. Similarly, in the case of other items of construction or of equipment the opportunity is given to the railroad to profit by good bargaining.

The prices of the Commission's scale are the maxima, and, if they are exceeded, the excess is not accepted for valuation purposes. Fifteen cents per cubic yard for excavation work is thought by the expert engineer to be a liberal allowance under present conditions, and, if the cost of excavation be represented by a company to have been seventeen cents, the excess of two cents is not allowed as a basis for the issue of securities. It is maintained that this practise is necessary in order to prevent collusive contracts between railroad companies and construction companies. It does not prevent such contracts, but it does put a check upon their abuse. Interest at 6 per cent. on the amount expended up to the time the securities are issued is also allowed.

Whether the scheme of a fixed scale of prices and of a fixed rate of interest works well or ill depends upon how closely the allowances approximate actual costs. In practise the allowances, including donations, have always exceeded cost. In the case of the latest long piece of construction in Texas the percentage of excess over the actual cost of the physical property is estimated to be 10 per cent. In the opinion of one of the Commissioners the percentage of excess has been as high as 25 per cent. The average, however, is probably between 10 and 15 per cent.

This excess may be regarded either as an allowance for promoter's profits or as an allowance for the future increase in the value of the road by reason of its becoming a seasoned and settled property. The Commission appears to be indifferent as to which is taken, yet an admission by it that the latter is the explanation of its practise could not be taken to imply, as might logically be expected, a recognition by that body of the non-physical or intangible value of a railroad as a basis for capitalization. As stated before, cost of reproduction is its basis. The Commission's concept of the value of the franchise is that it is the value of the right to occupy certain streets and public highways, and the practise has been to ascertain this value by reference to the value of the abutting property. This concept, it is needless to remark, is the legal, not the economic one, and it may be expected generally to result in an underestimation of the value of the franchise, in the economic sense, of a road that becomes a seasoned and settled property.

Two classes of roads are to be noted in a consideration of the administration of the law,—those constructed and capitalized before, and those after, its passage. The older roads, in existence when the law was passed, present the greatest difficulties for the Commission. Yet the effect of the act upon them, while of a delayed character, is nevertheless manifest. The average capitalization of these older roads has been reduced, owing to the fact that the capitalization of their extensions and mergers, the refunding of their old indebtedness, and the funding of their floating indebted-

ness have been subject to the provisions of the law. The question of the refunding of maturing funded indebtedness has not been before the Commission. Within the next few years some large issues will mature, and it will be interesting to see whether or not the opportunity will be taken to make the indebtedness of the roads more closely approach the Commission's valuation of them. Some reduction in the average has been effected by the payment of bonds, as in the case of the Houston & Texas Central, some by the cancellation of stock as a penalty, as in the case of the Aransas Pass. But these reductions have been small as compared with the decrease brought about as a result of new construction and mergers.

The results of the operations of debt payment and of mergers may be seen in the following table for the Houston & Texas Central Railroad, which shows the mileage, total stock and bonds, stock and bonds per mile, and average per mile of the Commission's valuation:—

<i>Year.</i>	<i>Mileage.</i>	<i>Total Stock and Bonds.</i>	<i>Stock and Bonds per Mile.</i>	<i>Average of Commission's Value per Mile.</i>
June 30, 1892	507 ¹	25,794,729	50,877	—
" " 1893	452.55 ²	26,463,420	58,476	—
" " 1894	452 55	26,341,420	58,206	21,186
" " 1895	452.55	26,263,420	58,034	21,186
" " 1896	452.55	26,249,420	58,003	21,186
" " 1897	452 55	26,204,420	57,904	21,186
" " 1898	452 55	25,442,000	56,219	21,186
" " 1899	507.75 ³	24,868,000	48,977	20,322
" " 1900	507 75	24,521,000	48,293	20,322
" " 1901	507.75	25,124,000	49,481	20,322
" " 1902	668.73 ⁴	27,346,000	40,892	19,255
" " 1903	690.03	26,827,000	38,878	19,819
" " 1904	690 03	26,471,000	38,362	19,819
" " 1905	690 03	25,911,000	37,551	19,819
" " 1906	694.78 ⁵	24,814,000 ⁶	35,715	19,819

¹ The mileage owned is reported to be 507. This includes the 54 miles of the Waco & Northwestern. The stock and bonds items also include the Waco & Northwestern.

² The stock and bonds outstanding are those on the main line (452.55 miles), and the apportionment per mile is over this amount. The Waco & Northwestern is in the hands of a receiver.

³ The increase in mileage is due to the merger of the Waco & Northwestern.

⁴ The increase in mileage is due to the merger of the Austin & Northwestern, the Central Texas & Northwestern, and the Fort Worth & New Orleans.

⁵ The increase in mileage is due to the addition of the Lancaster Tap.

⁶ Other indebtedness outstanding amounts to \$1,808,703, which raises the aggregate per mile to \$38,318.

When older roads, with a capitalization excessive as compared with the Commission's valuation, made extensions, the position was taken by the Commission that no stock and bonds could be issued unless the Commission's combined valuation of the old road and the extension exceeded the amount of outstanding securities of the old, and that only an amount equal to the excess could then be issued. In spite of this position there were minor extensions made. Evasion was not difficult; but this construction of the statute was regarded as an impediment to extensions, and an act of the legislature of April 15, 1901, empowered the Commission (tho it did not make it mandatory) to authorize the issue of securities to an amount equal to the reasonable value of an extension.

Again, the position was taken by the Commission that roads believed by it to be excessively capitalized could not issue securities on rolling stock and motive power so long as the outstanding securities exceeded the Commission's valuation of the road and its equipment. This was thought to stand in the way of the roads providing adequate equipment, and by an act of April 23, 1907, which requires the purchase of sufficient equipment for the expeditious handling of all passenger and freight traffic, the Commission, upon its own recommendation, was authorized to approve liens or mortgages for this purpose, even if the road has an excessive issue of stock and bonds. In 1898 the Commission had decided that it had no jurisdiction over rolling stock and equipment contracts; but in 1903 it reversed this opinion, and decided that it did have jurisdiction. Its construction of the statute following this assumption of power explains the passage of the act of 1907.

Under the commission act, as it was first passed, and again under the Stock and Bond Law, the Commission sought to obtain from the older roads information as to their original cost. The results were extremely unsatisfactory. In explanation of their failure to give the desired information, some of the roads alleged that original construction and equipment had been made by construction companies,

and that they themselves were not therefore in possession of a statement of the original cost; others that these accounts were outside the State; others that their properties had been acquired through judicial sale and that the accounts had not been turned over to them.

In view of these difficulties encountered in getting statements of cost from the roads, two alternatives were open to the Commission. One was to accept the outstanding capitalization as representing the reasonable value, the other was to make a valuation. The latter was chosen, and the valuation was made on the principle of cost of reproduction. The difference between the valuation and the capitalization was in every case considerable. Inasmuch as extensions may now be additionally bonded, one obvious method of reducing that difference no longer is available. In the future, besides the ways already mentioned, excision at refunding must be looked to as one way and increase in the Commission's valuation as another. The valuations of the older roads were completed by the end of 1895, and, while there have been requests for revaluations, the Commission has refused to allow them. Requests for revaluation have come also from roads built since the law went into effect, but these also have been refused. None of these requests went so far as to be given official hearings at which data and arguments would be adduced: they were disposed of in the ordinary course of correspondence. If the roads believed that they had a good case, it is difficult to understand why they did not press for a hearing. It would not be surprising if, when refunding is considered, the matter of revaluation should be made an issue.

One way of defeating the purpose of the Stock and Bond Law has been found, according to the Commission's report for 1906, in the issue of "income bonds." As well as can be ascertained, what is referred to as "income bonds" is really floating debt. The Commission now asks that it be given jurisdiction over the issue of interest-bearing evidences of debt that are not secured by liens upon physical property.

The report of the Commission for 1906 states that the

amount of bonds and receivers' certificates which have been approved since the passage of the Stock and Bond Law is \$38,256,566. The purposes for which these issues were made—that is, whether for new construction, for refunding, or for increased valuations—are not enumerated; but, so far as can be ascertained, the entire amount has been for new construction.

The following table shows the growth in mileage and the reduction in the average amount of stocks and bonds per mile since the enactment of the law:—

<i>Year.</i>	<i>Miles of Railway in Operation.¹</i>	<i>Stock and Bonds outstanding per Mile.²</i>
June 30, 1894	9,154	40,802
“ “ 1895	9,291	40,294
“ “ 1896	9,437	39,949
“ “ 1897	9,484	39,113
“ “ 1898	9,540	38,241
“ “ 1899	9,702	37,559
“ “ 1900	9,867	36,926
“ “ 1901	10,154	35,571
“ “ 1902	10,617	34,167
“ “ 1903	11,080	33,281
“ “ 1904	11,536	32,284
“ “ 1905	11,745	31,795
“ “ 1906	12,058	31,530

As previously suggested, the decrease in the average thus given is due to new construction whose capitalization was subject to the provisions of the law.

Current liabilities or floating debt do not come within the law. The increase of this class is a significant item, because it shows in a measure how the pressure of the law upon the roads has been temporarily relieved. The amount outstanding on June 30, 1896, was \$30,351,240; that on June 30, 1906, was \$76,536,656. Over one-half of this latter amount is chargeable to four roads, and of this half nearly one-half is chargeable to one road.

¹ The mileage used is that of main line, branches, and spurs. It is not the same as main mileage. The difference is not material for the purpose of showing the decrease in the average indebtedness.

² The amounts for 1905 and 1906 do not include the \$16,305,291 "certificates of indebtedness" of the Gulf, Colorado & Santa Fé. These are classified by the Commission under the item "Other indebtedness."

The older roads, which are in the main parts of systems and controlled by corporations domiciled outside the State, have by far the larger share of the total floating debt, and this has an ominous significance. The tendency is towards an increase of the amount, and, as the Commission's policy is to refuse to allow a funding of the indebtedness of this character, the older roads must rely upon increased earnings or a change of the Commission's policy to save them from grave financial difficulties.

In the case of these roads, which are already excessively capitalized, the position of the Commission is—logically under the law—that, where current liabilities are incurred for permanent improvements, the increased valuation of the property resulting from the improvements will be recognized, but that not until there is an approximation of total valuation to outstanding capitalization will an addition to bonded indebtedness be authorized. Inasmuch as the margin between the Commission's valuations and the roads' capitalization is very wide, that body has evidently felt safe in refusing to believe that improvements and other factors have caused an appreciation in value sufficient to wipe out the unfavorable margin and to entitle the companies to the boon of funding.

The situation as to newer construction is not so troublesome. The margin between the valuation by the Commission and outstanding capitalization being small, any floating indebtedness which may be construed to have resulted in an increase in the valuation of the property will, it is to be expected, not be refused funding.

What now has been the effect of the Stock and Bond Law upon railroad construction? A satisfactory answer is not easily given. It is impossible to say what would have been the increase in mileage if no such law had been passed, and it is difficult to gauge in its bearing upon the question the significance of the increase of practically 3,000 miles in the mileage since the law went into effect. It can be said with a reasonable degree of certainty that the law as it has been administered has afforded no encouragement to rail-

road building for large speculative gains. However, a consideration of the question of the alleged timidity of capital to enter the field of railroad investment in Texas on account of this law requires that attention be directed probably less to the stock and bond feature than to other features of the Texas law regulating railroads.

Important, tho perhaps not so much as the question as to new construction, is that of the effect of the law upon improvements and betterments. Does the law encourage the repair of depreciation, the substitution of heavy steel rails for lighter ones, the replacement of wooden bridges with steel ones, the reduction of grades, the abolition of curves, the ballasting of road-bed, better stations, etc.? Improvement of rolling stock has been provided for in the act of April 23, 1907; but other improvements are left subject to the original legislation.

The amount expended for permanent improvements in the year ending June 30, 1906, is stated to have been \$2,174,-161. For a railroad mileage aggregating that of Texas, this is a paltry sum. The seat of the trouble appears to lie in the income account. Of fifty-five roads reporting for the year ending June 30, 1906, there are seventeen which report a deficit of income for that year. Only five of the seventeen are charged, however, with expenditures for permanent improvements. Twenty-three of the fifty-five roads report a deficit as existing on June 30, 1906, and of these, six made permanent improvements. The deficit is pronounced in the case of several of the older roads.

The position of the older roads is thus, as regards improvements, a decidedly difficult one under the law. With interest charges and taxes consuming most of income, there is no large amount left for improvements, and none can be made without creating a deficit. As has been already explained, since their valuation by the Commission is much below their capitalization, they cannot, until this margin is wiped out, expect to have expenditures of this character funded. If the object of the Stock and Bond Law is to be realized, however, the construction of the law in this respect

cannot well be different. Rates might be raised so that income would be increased, and since only seven of the fifty-five roads reporting for the year ending June 30, 1906, paid any dividends, it is a question if the roads could not, with a fair degree of confidence, take the matter of an increase in rates to the courts if competitive conditions would permit them to make an increase.

The position of the newer roads as regards improvements is better. They have no penalty of trouble to pay for overcapitalization.

E. T. MILLER.